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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

APPRAISAL OF
KOREA DEVELOPMENT FINANCE CORPORATION

June 5, 1969

Development Finance Companies Department

CURRENCY EQUIVALENTS

U.S. \$1.00	=	Won 280
Won 1,000	=	U.S. \$3.57
Won 1,000,000	=	U.S. \$3,571

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SUMMARY

1. Although Korea Development Finance Corporation (KDFC) was incorporated in April 1967, its financing was completed only in February 1968, when the subscriptions of the foreign investors and IFC were paid in. The first Bank loan and the loan from United States Agency for International Development also became effective at the same time. KDFC approved its first loans and investment in July 1968.

2. The performance of the Korean economy has continued to be impressive. Real GNP rose 9% in 1967 and 13% in 1968 largely because of the very high rate of growth in the industrial sector, where private enterprise is dominant. Manufacturing contributed about 25% to GNP in 1968. Private sector investment grew by 107% over the First Plan period 1962-66. It amounted to an estimated Won 86 billion (\$315 million equivalent) in 1968 showing an increase of 88% over that in 1966.

3. KDFC's management is competent and has a high reputation in government, business and banking circles. Its staff is dedicated and capable. Office procedures, including appraisal and follow-up, are thorough and meticulous.

4. In its operations KDFC has made a sound start although, justifiably, a slow one. Its operations are gathering momentum. Up to March 31, 1969 KDFC had approved a total of \$4.6 million equivalent in loans and investments, of which \$2.5 million was in foreign exchange and \$2.1 million equivalent in domestic currency. The quality of KDFC's present small portfolio appears sound.

5. As of December 31, 1968, KDFC's assets consisted predominantly of bank deposits. Loans and investments were a very small part of the total assets, and the company had no long term debt except the subordinated Government loan. Its income for the year, derived almost entirely from interest on deposits, amounted to 23% of the year-end equity, but this nominally satisfactory return was significantly reduced by continuing inflation at the rate of roughly 10% per annum. As of December 31, 1968, KDFC's shares had a book value equal to 140% of par.

6. KDFC is not expected to face the problem of lack of business. KDFC's domestic currency lending and investments may be limited by the difficulty of replenishing won resources. KDFC does not foresee a similar difficulty in replenishing its foreign currency resources.

7. KDFC's commitments of foreign currency loans up to the end of 1970 are estimated at \$21.0 million, and about \$29 million up to June 30, 1971. As of January 1, 1969, it had uncommitted foreign exchange resources amounting to \$9.5 million. The need for additional foreign exchange resources is therefore \$11.5 million to meet estimated commitments up to December 1970, and \$19.5 million through mid 1971.

8. The Bank appears to be the main potential lender of foreign exchange to KDFC in the next two years. A loan of \$20 million would be fully committed by about the middle of 1971. The loan should be made on terms and conditions similar to those of recent Bank loans to development finance companies including the standard commitment charge. The "free limit" should be raised to \$300,000, with a limit on the aggregate amount to be credited under the free limit of US\$5 million.

BASIC DATA

KOREA DEVELOPMENT FINANCE CORPORATION

	<u>Won in million</u>	<u>Percent</u>
<u>Ownership</u> (as of January 31, 1969)		
Korean banks (predominantly government owned)	200	15
Korean insurance companies (private)	200	15
Korean private investors	<u>420</u>	<u>31</u>
Total Korean	820	61
IFC	192.5	14
Foreign investors	<u>337.5</u>	<u>25</u>
Total	<u>1,350</u>	<u>100</u>

Resource Position (as of March 31, 1969)

<u>Domestic currency</u>	(<u>Won in million</u>)
Equity (December 31, 1968)	1,893
Government subordinated loan (ranking <u>pari passu</u> with share capital)	<u>2,025</u>
Total domestic currency resources	3,918
Domestic currency loan and equity investment commitments	550
Domestic currency resources available for commitment	<u>3,368</u>
<u>Foreign currency</u>	<u>US\$ in thousands</u>
IBRD loan	5,000
Other (AID loan)	<u>5,000</u>
	10,000
Foreign currency loan commitments	<u>1,216</u>
Foreign currency resources available for commitment	<u>8,784</u>

Operations Approved (up to March 31, 1969)

Domestic currency loans	W 440 million
Domestic currency equity investments	W 140 million
Foreign currency loans	\$ 2,539,000

Amounts Disbursed (up to March 31, 1969)

Domestic currency loans	W 276 million
Domestic currency equity investment	W 140 million
Foreign currency loans	\$ 257,000

Earnings Record (percentages)

1968

Earnings before provisions and tax to average total assets	17.9
Net profit to average total assets	17.9
Net profit to average equity	30.9
Net profit to share capital	32.3
Dividend paid	nil

Financial Position (as of December 31, 1968)

Current ratio	32.1
Total debt/equity ratio	1.1:1
Conventional LT debt to equity plus subordinated debt (limited to 3:1 under existing Bank loan agreement)	-
Subordinated debt to equity	1.1:1
Subordinated debt to share capital	1.5:1

Interest Rates and Charges

Interest rate on domestic currency loans	20%
Interest rate on foreign exchange loans	10%
Commitment charge (on foreign currency loans)	3/4 of 1% p.a.

APPRAISAL OF
KOREA DEVELOPMENT FINANCE CORPORATION

I. INTRODUCTION

1. This report examines the suitability of KDFC as a borrower for a second Bank loan. The first loan of US\$5 million was approved by the Executive Directors on January 30, 1968. The report concludes that KDFC is justified in seeking a second Bank loan towards meeting its estimated requirements of foreign exchange during the next two years and that it is a suitable institution for the Bank to lend to. This conclusion, and the report, is based on the experience of a close relationship between the Bank Group and KDFC, its sponsors and management since inception of the company; and on the findings of a mission that visited Korea in January-February 1969 to reappraise KDFC.

2. Although KDFC was established as a legal entity in April 1967, its financing was completed in February 1968, by prior agreement between the Bank Group and KDFC, when the subscriptions of the foreign investors and IFC were paid in. The Bank and AID loans also became effective at that time. KDFC approved its first loans and investment in July 1968.

II. ENVIRONMENT

General Economic Setting

3. A recent review of the economy of Korea is found in the report dated March 10, 1969 "Current Economic Position and Prospects of the Republic of Korea," EAP-4a.

4. The current Second Five-Year Plan was launched in 1967 and covers a period up to and including 1971. The plan envisaged a growth rate of 7% per annum. Mining and manufacturing was expected to be the most dynamic sector, growing at an average rate of about 13% per annum. In 1961 manufacturing accounted for about 15% of the Gross National Product. The contribution of this sector to GNP increased to about 22% in 1965; the Second Five-Year Plan envisages that by 1971 it will increase to 27%. One of the basic elements of the strategy of development adopted at the beginning of the Second Plan was to increase exports to provide a rising proportion of the foreign exchange needed to finance industrial imports.

5. The performance of the Korean economy during the first two years of the Plan has been better than the target. Real GNP rose by 9% in 1967 and by an estimated 13% during 1968, in spite of droughts which adversely affected agriculture during the period. The increase was mainly due to the very high growth

rate of the industrial sector. Mining and manufacturing grew at the rate of 22.5% in 1967 and at an estimated 26.2% in 1968, accounting in that year for almost 25% of the GNP. Manufacturing also accounted for an increasing share in Korea's exports which rose from an annual average of US\$ 87 million in 1962-64 to US\$ 320 million in 1967 and to about US\$ 500 million in 1968. Manufactured goods accounted for \$ 215 million or 67% of Korea's total exports in 1967, and according to provisional estimates represented an even higher proportion in 1968.

6. As part of its development strategy, the Government has placed great reliance on the private sector to increase its investments in the mining and manufacturing sector, and has provided various encouragements and incentives. Investment in the private industrial sector during the First Plan period (1962-66) increased by about 107% (compared with an increase of about 65% in the public sector investment), and amounted to about W 48 billion in 1966. During 1967 investment in the private sector increased further to about W 79 billion and, according to provisional figures, amounted to W 86 billion (US\$ 315 million equivalent) in 1968. This trend is expected to continue during the remaining period of the Second Plan and beyond.

7. The private sector is predominant in the manufacturing field though the Government has some industrial investments in such heavy industries as petrochemicals, fertilizer and engineering. During the last few years, producer-goods industries have expanded more rapidly than consumer-goods industries, although the latter are still dominant. The textile industry (cotton, synthetic, raw silk, clothing, footwear) contributed about 30% of the manufacturing sector's gross value added in 1967 and continues to be the largest industry. A feature of the manufacturing sector is the increasing average size of industrial enterprises. The share of large-scale enterprises (those having a total labor force of 200 or more) increased from one-third of gross value added in 1960 to more than one-half in 1966. The share of small-scale enterprises (less than 50 employees), on the other hand, decreased from 47% of gross value added to 27% during the same period; though the number of such enterprises was still rising. The share of medium-scale enterprises has remained more or less unchanged.

8. The extraordinary growth in the manufacturing sector has been made possible by the qualities of Korean entrepreneurship and labor, as well as heavy capital investment. Industries such as electronics and textiles, which are labor intensive, have demonstrated a high degree of international competitiveness. Production costs are relatively high in the case of those capital-intensive industries where the size of individual units is limited by the relative smallness of the market. (Machinery and petrochemical industries are examples.) Tariff protection to industries has been accorded on a selective and rational basis: the higher the real value-added of the industry concerned, the higher is the tariff set because such industry contributes more to the domestic economy than an industry with a low real value-added.

9. Effective October 1, 1968, the negative interest rate structure, under which banks had been paying higher rates on deposits than they received on loans, was modified by the Government. The maximum deposit rate, now 25.2%, matches the rate for commercial bank lending. The Government-owned long-term lending

institution, the Korean Reconstruction Bank (paragraph 11), also revised its lending rates at the same time. It now charges 20% and 23% for capital equipment loans and working capital loans respectively. It continues to charge concessional rates, however, for industries such as utilities, coal mining, iron and steel and shipbuilding.

10. The rise in the level of prices slowed somewhat in 1967 and 1968. The wholesale price index and the Seoul consumer price index increased by 6% and 10% respectively in each of the years 1967 and 1968, as compared with 9% and 12% respectively in 1966.

Industrial Financing Institutions in Korea

11. The financial institutions providing medium- and long-term industrial financing in Korea, other than KDFC, are the Korean Reconstruction Bank (KRB) and the Medium Industry Bank (MIB), both Government-owned and managed. KRB is by far the biggest institution, both in terms of size of resources and volume of operations. It was established in 1954 and initially concentrated its operations on rehabilitation of facilities damaged during the Korean war. Since its inception KRB has followed a policy of supplying only such funds as other banking institutions find difficult or impossible to extend. The Government has used KRB for implementing a variety of programs. For instance, KRB has served as a vehicle for making loans for Government-initiated industrial projects; it has also been a principal source of housing construction loans. During 1967, KRB's total investments amounted to W 18.6 billion (about \$66 million) in respect of 234 projects. Fresh resources made available to KRB during that year amounted to W 20.7 billion (about \$74 million). According to KRB's operational program for 1969, yet to be approved by the Government, total investments in 1969 are expected to be W 35.3 billion (\$ 126 million). Mining and manufacturing sector is estimated to account for about 34% of the total. In the manufacturing field, KRB, under Government directives, will give priority to steel, heavy machinery, fuel and petro-chemical industries.

12. MIB was established in 1961 to provide finance to smaller scale industries. As of June 30, 1968, it had total loans outstanding amounting to W 22.3 billion of which about 95% was in the manufacturing field. Of the total amount outstanding as of June 30, 1968, about 70% was in respect of working capital loans; only about 30% was in respect of plant and equipment loans. According to MIB's operational program for 1969, now approved by the Government, MIB's total investment during the year will amount to W 12.5 billion (US\$ 44.5 million) provided its resources are substantially increased.

13. A new institution, Korea Investment Development Corporation (KIDC), was established in December 1968. Its authorized capital, US\$ 5 million equivalent, has been subscribed by the Government; one-third directly; one-third through KRB; and one-third by the commercial banks, which are predominantly Government-owned. KIDC's main objective is to develop a capital market in the country.

and to encourage a healthy growth of the stock exchange. KIDC will underwrite share and bond issues, and assist and encourage the public marketing of shares in established companies which are presently closely held. The Governor of KIDC is also a director of KDFC, and the two institutions expect opportunities of close collaboration.

14. At the time KDFC was set up, the Government stated that it expected KDFC to become the principal source of medium and long term financing for the private sector. While KRB and MIB are active in their respective fields, and have relatively large resources, KDFC's operations have not suffered from competition.

KDFC's Relations with Government, the Business Community and Other Financial Institutions

15. KDFC, sponsored by a group of leading Korean businessmen, was established with the active cooperation and support of the Government. The Government provided KDFC with a subordinated loan amounting to 1.5 times its paid-in capital (paragraph 22) and exempted IFC and the foreign shareholders from the application of certain restrictive provisions of the Foreign Capital Inducement Law. The Government believes that it is in the best interests of Korea that KDFC should remain independent in its policies and operations. Inevitably, KDFC's management has from time-to-time encountered pressures from both public and private sources. A notable example was the effort to persuade it to lower its lending rate on Won loans. The Board initiated a series of studies and discussions, as a result of which it decided not to change KDFC's rates at the present time; (see paragraph 43).

16. Among the business community, KDFC has the reputation of being a sound institution. There is some criticism that KDFC is too slow in taking investment decisions, asks too many questions, and sets its project standards too high. KDFC was naturally cautious in taking its first investment decisions, and expected the inevitable accusation of slowness, which a new development finance company always meets. More experience and a growing scale of operations should deal with such criticism.

17. KDFC's relations with the Bank Group are close and cordial. The President, Mr. C. H. Kim, consults the Bank and IFC on important matters. Mr. Y. L. Chang, who represents IFC on KDFC's Board, has attended four out of seven meetings of the Board held since he became a director in February 1968. Both KDFC and IFC are seeking opportunities of joint financing in Korea. KDFC's relations with foreign financial institutions are also good, particularly with its shareholder banks.

III. DESCRIPTION OF KDFC

Objectives

18. The objectives of KDFC, a private development finance company, are to assist in the creation, expansion and modernization of private industrial enterprises; to encourage, sponsor and secure participation of private capital, domestic as well as foreign, in such enterprises; to assist in the expansion and stimulation of the capital market; and to improve technical, financial, managerial and administrative practices of private enterprises in Korea. It may extend long and medium term loans, make equity investments, underwrite and sponsor equity and debt security issues, and guarantee, counter-guarantee or otherwise secure the payment of loans and other debt obligations.

Share Capital and Ownership

19. When KDFC was established in April 1967, its share capital was W820 million, all subscribed by Korean investors. When KDFC's financing was completed in February 1968, the paid-in capital was raised to W1,350 million, with a group of foreign private investors subscribing W337.5 million and IFC W192.5 million. Of the total paid-in capital, 15% is held by Korean commercial banks (predominantly Government-owned), 15% by insurance companies, and 31% by Korean private investors, most of whom are members of the Federation of Korean Industries. Foreign investors hold 25% of the total paid-in capital. IFC's holding (\$0.71 million equivalent) is about 14% of the total capital. A list of major shareholders is given in Annex I.

Resources

20. KDFC's long term resources consist of its paid-in share capital, reserves and retained earnings, a subordinated government loan, a loan from US AID, and a loan from the Bank.

21. Share capital and reserves. As of December 31, 1968, KDFC's equity amounted to W1,893 million (US\$6.76 million equivalent). No dividend was paid for the year 1968 and all the earnings were retained to strengthen the equity base.

22. Subordinated Government loan. As part of KDFC's initial capitalization, the Government granted KDFC a loan amounting to W2,025 million (equivalent of US\$7.5 million at the exchange rate obtaining at that time.) The loan is for a period of 40 years including 10 years' grace. It will rank subordinate to all other debt and pari passu with the share capital in the event of liquidation of the company. KDFC pays interest on the loan at the rate of 14% per annum. By agreement with the Government at the time the loan was made, KDFC has deposited the proceeds of the loan with KRB and receives interest on the outstanding balance at the rate of 10% per annum. The net income to KDFC on this loan is therefore 6% per annum until funds are withdrawn by KDFC for long term investments. A simple procedure has been devised for the withdrawal of funds by KDFC.

23. Foreign exchange loans. Two foreign exchange loans were part of KDFC's initial capitalization:

(i) \$5 million loan from AID. This is a two-step loan with AID lending to the Government for 40 years and the Government re-lending to KDFC for 15 years with a grace period of 3 years from the date of first disbursement under the loan. KDFC pays interest at the rate of 6% per annum. Disbursements under the loan are tied to procurement in the U.S.A. As of May 31, 1969, an amount of \$495,000 had been committed. KDFC expects that the full amount of the loan will be committed in early 1970.

(ii) \$5 million loan from the Bank. The loan was made on terms usual for such loans to development finance companies, except that, since KDFC was a new institution at the time the loan was made, the Loan Agreement provides for the commitment charge to be levied only on amounts actually credited to the loan account. As of May 31, 1969, the Bank had credited \$2.74 million to KDFC's Loan Account. KDFC expects that the full amount will be committed by July/August 1969.

Organization, Management and Staff

24. Board of Directors. The initial Board elected in April 1967 consisted of 9 Korean directors. At the time of completion of the financing in February 1968, three new directors representing the foreign investors and one representing IFC were elected. The present Board (Annex II) consists of 13 directors with the following composition:

President	1	
Korean private shareholders	5	
Korean banks and insurance companies	<u>3</u>	9
IFC		1
Foreign shareholders		<u>3</u>
		<u>13</u>

By a voting agreement, the shareholders have agreed to maintain the above composition of the Board. The Chairman of the Board is Mr. C. S. Hong, one of the leading industrialists of Korea, who was until recently also the Chairman of the Federation of Korean Industries.

25. Executive Committee. An Executive Committee consisting of 4 directors has been authorized by the Board to approve individual investments up to \$500,000 equivalent. The decisions of the Committee are taken by majority vote but any member of the Committee may request that a matter be referred to the full Board for decision. Investments of more than US\$500,000 equivalent require the affirmative recommendation of the Executive Committee before being submitted to the Board.

26. Management. KDFC's management presently consists of the Chairman, the President and two Vice Presidents, assisted by an Advisor. It is a strong management.

27. The President of KDFC, Mr. C. H. Kim, was formerly Governor of the Bank of Korea. Mr. Kim has already proved himself an able chief executive of KDFC. KDFC's practices and procedures are so arranged that the company does nothing significant without Mr. Kim's prior knowledge and consent.

28. Consultation between the President and the Chairman is frequent and close. The Chairman's continuing support of the President on large and controversial issues is vital.

29. KDFC's Vice Presidents are Mr. M. J. Choi and Mr. C. K. Lee. Mr. Choi was formerly a director of KRB where he acquired considerable knowledge and experience of long term lending. Mr. Lee, who joined KDFC in March 1969, is a banker by profession. Immediately before he joined KDFC, he was Executive Vice-President of Bank of Seoul, a leading commercial bank in Korea.

30. In compliance with a condition of the Bank Loan Agreement, KDFC engaged, in March 1968, an Advisor. He is Mr. C. L. Terrel, who has had long experience in industrial financing and related fields in a number of developing countries, including Ghana, Nigeria and Taiwan. Mr. Terrel is making a valuable contribution to management decisions, project appraisal and staff training. His initial contract was for two years, but it is being renewed. This is in KDFC's interests.

31. Organization and Staff. The staff is grouped in 4 departments, each headed by a department manager responsible directly to a Vice President. The departments are: (i) Investment Appraisal; (ii) Operations (end-use supervision); (iii) Planning and Control; and (iv) Administration. The organization chart is shown in Annex III. Apart from the management, the professional staff numbers 19. There are also 5 professional trainees who recently graduated from college. Mr. Kim has chosen the staff carefully, and its members appear to be competent and dedicated. Given the volume of business available, three or four more professionals with between five and ten years of relevant experience are needed. KDFC's management is seeking to recruit them.

Procedures

32. Appraisal of Investment Proposals. An applicant files a preliminary outline of proposal together with the latest available financial statements, where appropriate. The staff review of the proposal is recorded and considered by the Vice Presidents and President. It is they who decide whether or not KDFC will proceed further. If the decision is to proceed, an interview is arranged with the applicant. He is given a formal application form together with a copy of KDFC's "Guide for Applicants." The interview is conducted by the Manager of the Investment Appraisal Department and KDFC's Consultant Engineer, who works part-time for KDFC. The formal proposal (in the preparation of which KDFC frequently helps its clients) is processed simultaneously by three professionals; an engineer, a financial analyst and a marketing man. They aim to draw up a

preliminary feasibility report within a period of 1-2 weeks on the basis of which the President decides whether or not a full appraisal will be made. If the decision is to go ahead, the applicant is asked to submit recent financial accounts audited by a CPA. The engineer makes one or more site inspections. The marketing man subsequently writes the overall report. The departmental Manager, or the individual officers working on the proposal, consult the Advisor as need arises. The management is also kept concurrently informed. The completed report is reviewed by the Advisor, after which it goes to the President for his final approval before being presented to the Executive Committee.

33. The quality of KDFC's appraisal work is good in most respects. The coverage of the engineering, financial, marketing and management aspects of a project is usually comprehensive and analytical. The appraisal reports indicate that KDFC also gives some thought, but not always sufficient thought, to the economic aspects of the projects it finances. The calculation of the effects of execution of each project on Korea's balance of payments and on employment is a standard practice. An attempt is also made, when appropriate, to assess the direct and indirect benefits accruing from the introduction of modern technology. KDFC's appraisals do not, however, always consider the international competitiveness of production costs. This is being discussed with KDFC.

34. Follow-up. In some respects, the work of the Operations Department starts even before a loan proposal is put to the Executive Committee or Board. As soon as the management has decided to undertake a full appraisal, the Operations Department starts its evaluation of the security for the proposed loan, which is usually a senior mortgage. By the time the proposal goes to the Executive Committee, the evaluation of the security is complete, and the drafting of loan papers is in hand. The Department helps the borrower to draw up procurement contracts, to arrange insurance, and to obtain the necessary import permits. The borrower is required to submit quarterly reports to KDFC. Those reports are promptly analyzed by KDFC's staff, and submitted to the management with a recommendation for action when appropriate.

35. As in other aspects of its work, KDFC has made a good start on end-use supervision. The adequacy of its procedures will have to be reassessed when they apply to a portfolio larger than KDFC's present very small one.

IV. POLICIES, OPERATIONS AND FINANCIAL RESULTS

Policies

36. As a guideline to KDFC's operations, the Board has adopted a Statement of Investment and Operational Policies (Annex IV). It provides that KDFC will make its investment decisions on the basis of sound investment criteria; will diversify its loans and investments; will turn over its portfolio as it can; will not take a controlling interest in any enterprise it finances; will limit its debt to prudent amounts; will lend and invest in a manner best calculated to maintain the value of its capital; will protect itself against foreign exchange risk; will build up a staff suitable to its objectives; will follow a sound

reserves policy; will have an annual independent audit, etc. The Policy Statement also provides that while KDFC's primary field of activity is in the manufacturing and the processing industries, it may invest also in other types of enterprises, including transport, tourism and large-scale commercially oriented agriculture.

37. In terms of the existing Bank Loan Agreement with KDFC, any amendment of the Statement requires prior approval of the Bank. The Statement of Investment and Operational Policies is both appropriate and adequate.

Operations

38. Lending activity. KDFC made its first investment decisions in July 1968. Up to March 31, 1969, KDFC had approved 11 loans and one equity investment for a total amount of US\$ 4.6 million equivalent (W580 million and \$2.5 million). As of the same date, the amount committed was W550 million in domestic currency and \$1,216,000 in foreign exchange. Disbursements against foreign exchange loans amounted to \$257,000 as of March 31, 1969; those against domestic currency loans and equity investment amounted to W416 million. As of the same date, KDFC had under active consideration loan applications amounting to W746 million in domestic currency and \$6.3 million in foreign exchange. A summary of KDFC's operations up to March 31, 1969 is as follows:

<u>Stage</u>	<u>Cumulative Total</u>		
	<u>No.</u>	<u>Won</u> <u>In million</u>	<u>Foreign Exchange</u> <u>In thousand \$</u>
Proposals received	69	4,253	21,857
Rejects ^{1/} and/or withdrawals	43	2,707	12,436
Approved by KDFC ^{2/}	12	580 ^{3/}	2,539 ^{3/}
Agreements executed ^{2/}	8	550	1,216
Disbursements ^{2/}	7	416	257
Repayments	-	-	-

^{1/} Rejections usually take place at the preliminary screening stage. Examples of the reasons for which KDFC has rejected proposals are unsatisfactory management, weak financial position and doubtful market prospects.

^{2/} Includes investments in the form of equity and debenture.

^{3/} Net of cancellations.

39. Size of Loans. KDFC's smallest and biggest loans so far have been in domestic currency, the smallest being W40 million (\$143,000 equivalent) and the biggest W200 million (\$714,000 equivalent). The average size of all the loans made by KDFC up to March 31, 1969 is W107 million (\$384,000 equivalent). The amounts of the smallest and biggest foreign exchange loans made up to the same date are \$155,000 and \$495,000 respectively.

40. Period of Loans. The period of the foreign exchange loans made by KDFC so far is usually 8 years; that for the domestic currency loans is usually 5 years. The most common grace period is 2 years.

41. Security for the Loans. A senior mortgage on the applicant's factory is the usual security obtained by KDFC. This is often supplemented by personal guarantees by the sponsors of the projects. In a few cases, KDFC obtained a commercial bank's guarantee as the principal security for its loans.

42. Rate of Interest and Other Charges. KDFC charges 10% on foreign currency loans and 20% on won loans. It also charges a commitment fee of 3/4 of 1% on foreign currency loans. There are no other charges or fees.

43. KDFC's Board frequently reviews its interest rates. The rates of 10% and 20% for foreign exchange and won loans respectively were adopted when KDFC made its first investment decisions, in July 1968, and have not since been changed. Following its most recent review, in December 1968, the Board decided that the rate of 20% on domestic currency loans was the lowest that could be justified in view of (a) the structure of prevailing interest rates in Korea, (b) the danger that KDFC funds would be diverted to low priority uses if too low a rate were charged, and (c) the likely level of inflation and consequent threat of impairment of KDFC's capital. As stated in paragraph 10, the rate of interest currently paid by Korean commercial banks on deposits is 25.2%.

44. Equity Investments. As of March 31, 1969, KDFC had made one equity investment of W140 million in a synthetic textile company, and was considering another of W200 million, in a glass manufacturing company. KDFC is actively seeking opportunities for additional investments. It will meet the usual difficulty that arises when most of the leading entrepreneurs prefer the shares of the companies to be family-held or controlled by a small group. On the other hand, efforts are presently being made in Korea to induce a wider dispersal of shareholdings. KDFC should be able to increase its equity investments through the opportunities so created.

45. Industrial Diversification. Of the 12 loans and equity investment approved by KDFC up to March 31, 1969, seven went to textile enterprises, in a total amount of about \$2.5 million equivalent. The projects financed were in various branches of the textiles industry: cotton, synthetic fibers and raw silk. Other loans have been made to the glass, food processing, electrical equipment and metal industries. The present emphasis on the textiles industry in part reflects the fact that textiles is the biggest industry in Korea. It is also highly competitive in international markets. The approval of projects presently being considered by KDFC is likely soon to make its portfolio more diversified.

Quality of Portfolio

46. KDFC's portfolio is at present small and new. KDFC is operating in a seller's market, however, and has appraised and selected all its investments with particular care. Given the care in appraisal and in view of the management and profitability records of the client companies, KDFC's portfolio appears to be good.

Financial Results and Position

47. Although KDFC was formally established in April 1967 and its financing was completed in February 1968, it did not make its first investment decisions until July 1968. Its assets therefore consist predominantly of current and time deposits, and its income so far has been derived almost exclusively from interest on such deposits. Balance sheets as of December 31, 1967 and 1968 are given in Annex V and are summarized here:

	<u>Won in thousands</u>	
	<u>1968</u>	<u>1967</u>
<u>ASSETS</u>		
Current assets	3,560,134	521,293
Time deposits due after one year	7,000	382,000
Loans and Investments	300,000	-
Others	<u>57,105</u>	<u>25,218</u>
	<u>3,924,239</u>	<u>928,511</u>
<u>LIABILITIES AND EQUITY</u>		
Current liabilities	1,112	1,273
Subordinated Government loan	2,025,000	-
Others	5,000	-
Equity	<u>1,893,127</u>	<u>927,238</u>
	<u>3,924,239</u>	<u>928,511</u>

As is apparent from the above summary, KDFC's liquidity position as of December 31, 1968 was very comfortable, and it had no long term debt except the Government loan. Loans and investments were still a very small part of the total assets. These features are as expected for a development finance company which has not yet completed its first full operating year.

48. KDFC's net income in 1967 and 1968 amounted to W107 million and W436 million respectively, representing a return on share capital and equity of 20.5% and 17.4% respectively in 1967 and 32.3% and 23.0% respectively in 1968. Audited Income Statements for the two years are given in Annex VI.

49. Cost of resources and spread. The average cost to KDFC of its foreign exchange resources is currently 6.25%. With the lending rate set at 10%, KDFC gets an average spread of 3.75% on foreign exchange loans. On domestic currency loans, the spread appears large because of the relatively low cost Government loan to KDFC and the generally high structure of interest rates in Korea. So long as the proceeds of the Government loan are kept on deposit with KRB, KDFC gets 6% net; when the funds are withdrawn from KRB and lent to KDFC's clients, the spread is increased to 16%. However, the spread is only nominally high, for it is vitiated by inflation, still proceeding at the rate of roughly 10% per annum (see para. 10).

50. Dividend; Share Value. Although KDFC earned 32.3% on its share capital in 1968, it did not pay a dividend, because its income was derived almost totally from interest on deposit of funds. As of December 31, 1968, KDFC's shares had a book value equal to 140% of par.

V. PROSPECTS

51. As noted in paragraphs 4-8, the Korean economy is moving ahead strongly with emphasis on the manufacturing sector, where private enterprise is dominant. Investment in the private sector has increased rapidly in recent years and is expected to grow further. Compared with the provisional figure of investment in the private sector in 1968, W86 billion (\$315 million equivalent), the Government estimate for 1969^{1/} is W95.8 billion (\$351 million equivalent). KDFC is not expected to face the problem of lack of business. Its operations so far have been limited, and are expected to continue to be limited in the near future, more by its staff resources than by demand for financing.

52. The demand for foreign exchange appears to exceed that for Won loans. KDFC foresees considerable difficulty, however, in replenishing its won resources during the next three or four years. KDFC does not consider it feasible in the near future to augment its won resources except by increases in its equity. It proposes to increase its paid-in capital in 1971 and 1973. KDFC is therefore following a policy of rationing the use of its domestic currency resources at a rate of commitment which will make them last until new resources can be raised. It does not foresee a similar difficulty in raising new foreign currency resources. As a result KDFC's projection of the volume of business for the years 1969-1973 shows a ratio of 3.7:1 for foreign currency commitments to won commitments.

53. A statement showing the forecast of KDFC's loan and equity approvals, commitments and disbursements is given in Annex VII. The estimates of approvals and commitments for the year 1969 are made on the basis of proposals already

^{1/} As reported by KDFC.

before KDFC and in various stages of investigation. Estimates for the years 1970 through 1973 take into account the total estimated demand of the private industrial sector for loans and equity investments, the estimated share of other financial institutions, and the initially constraining factor of KDFC's staff resources. The estimates are reasonable and, barring unforeseen developments, KDFC should be able to achieve them. A summary of past and projected foreign exchange loan approvals and commitments is given below:

(\$ 000)

	<u>Approval</u>	<u>Commitment</u>
1968 (actual)	2,128	461
1969 (actual up to 3/31)	2,539	2,539
1969 (full year estimate)	10,000	8,150
1970	13,800	12,850
1971	16,600	15,900
1972	19,100	18,475
1973	21,500	20,275

54. As of January 1, 1969, KDFC had uncommitted foreign exchange resources amounting to \$9.5 million. Foreign exchange commitments from January 1, 1969, up to end 1970 are estimated to amount to \$21.0 million. Commitments up to June 30, 1971 are estimated to amount to about \$29 million. KDFC will therefore need additional foreign exchange resources of the order of \$11.5 million to meet estimated commitments to the end of 1970 and of \$19.5 million through June 30, 1971.

55. Among potential lenders of foreign exchange other than IBRD, only the Asian Development Bank (ADB) appears at present to be a possible source. KDFC hoped for a small loan from ADB in 1969, but the Government apparently decided that other projects in Korea had a prior claim on any funds that might be forthcoming from ADB for the present. ADB has concurred in this view.

56. Other potential lenders to KDFC are Kreditanstalt fur Wiederaufbau (KfW) and AID. KDFC intends to approach KfW at an opportune moment, after enlisting the support of its German shareholder, Deutsche Bank. However, KDFC is unlikely to obtain a loan before the second half of 1971. AID too does not expect to make a second loan to KDFC in the next two years.

57. KDFC recently entered into an arrangement with Caterpillar Far East Ltd., under which the latter has agreed to provide a line of credit amounting to \$5 million to KDFC to finance purchases of Caterpillar equipment from the United States. The arrangement represents an experiment on the part of KDFC to diversify its sources of foreign exchange funds. There is no basis for KDFC, yet, to estimate the period over which it could reasonably be expected to utilize the Caterpillar loan. As the loan will be tied both as to country of procurement (the U.S.) and as to supplier (Caterpillar), for the purchase of a limited range of equipment, it is unlikely materially to affect KDFC's requirements of free foreign exchange.

58. In the light of the foregoing, the Bank appears likely to be the main potential lender of foreign exchange to KDFC in the next two years. KDFC would need about \$20 million to cover its foreign exchange requirements until mid 1971, on a commitment basis.

59. Projected Income and Profitability. Projected income statements for the years 1969-1973 are given in Annex VIII. KDFC's net profit (after tax) is expected to increase from \$1.4 million in 1969 to \$2.9 million in 1973. As a percentage of share capital it would amount to approximately 29% in 1969 and approximately 20% in 1973. As a return on total equity (end of the period) the net profit would amount to 18.4% in 1969 and 16.7% in 1973. The decrease in profitability in relation to both share capital and equity is due partly to the planned increases in KDFC's share capital in 1971 and 1973, and partly to the higher incidence of taxation in 1973. The real return on the shareholders' equity will be considerably less, however, when inflation is taken into account. KDFC presently proposes to start paying a dividend in 1970, in respect of the results of 1969.

60. Debt/Service Coverage. Projected cash flow statements for the years 1969 through 1973 are given in Annex IX. These and the projected income statements show that the debt service cover would be adequate. Annual interest payments throughout the period of the forecast will not be more than half the amount of KDFC's annual profit before financial expenses. Repayments by KDFC in any one year will at the most amount to 0.7 times the collections received by it during the same year.

61. Debt service cover beyond the period covered by the projections would also remain satisfactory. Repayments by KDFC in respect of the Government loan will start from December 31, 1977. Up to that time therefore the total collections by KDFC will always be more than its repayments to its creditors by a comfortable margin. Cover is estimated at about 1.5 times. This will decline to about 1.3 times after the repayments start in respect of the Government loan. As for the interest payments, KDFC's current income would be adequate to cover them.

62. Projected Balance Sheets. Total assets are expected to grow at an average annual rate of about 44% during the five-year period, 1969 through 1973 (from \$18.8 million at end-1969 to \$79.5 million at end-1973). The liquidity position is estimated to remain satisfactory throughout the period of the forecast. Total loan and investment portfolio is estimated to grow from \$6.0 million in 1969 to \$30.1 million in 1971 and \$68.9 million in 1973. Total outstanding long term borrowings are expected to increase from \$10.5 million in 1969 to \$28.3 million in 1971 and to \$59.5 million in 1973. The ratio of total long-term debt (including the subordinated Government loan) to equity is estimated to increase from 1.3:1 in 1969 to 3.7:1 in 1972 and then decline slightly in 1973 to 3.4:1 as a result of an increase in the paid-in capital in that year. Debt/equity ratio as defined in the Bank Loan Agreement is estimated to remain well below the ceiling allowed, 3:1, throughout the period of the estimates. It is estimated to reach its highest point in 1973 when it will be 2.1:1. A summary of forecast capital structure of KDFC is given in the following:

(000 US\$ equivalent)

	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
Current liabilities	589	589	1,109	1,699	2,768
Conventional long-term debt	3,113	8,456	20,898	35,908	52,109
Subordinated long-term debt	7,364	7,364	7,364	7,364	7,364
Share capital	4,909	4,909	9,909	9,909	14,909
Reserve and surplus	2,831	3,741	1,448	1,738	2,396

Projected balance sheets as at December 31, 1969 through 1973 are given in Annex X.

VI. CONCLUSIONS AND RECOMMENDATIONS

63. KDFC has made a sound start. The management is competent and has ably handled the affairs of the company in its initial period. It has succeeded in assembling a capable staff whose potential is high. Appraisal standards are good and end-use and other procedures are thorough and meticulous. The quality of the present small portfolio is sound, and KDFC's operations have been profitable.

64. With the overall economic outlook favorable, there should be increasing investment in the private industrial and allied sectors. The demand for medium- and long-term financing from these sectors is also expected to continue to rise. KDFC was set up to be the principal source of such financing. The demand for the type of financial assistance KDFC offers is heavy and is expected to continue to be so. Provided that it gets the proposed second Bank loan, its operations will continue, at least in the near future, to be limited by its staff resources rather than by lack of business. The management is making adequate efforts to train and recruit staff.

65. KDFC has decided to follow a policy of conserving its existing domestic currency resources in view of the expected difficulty in augmenting them by other than equity increases. This policy is justified for the present.

66. KDFC's forecast of foreign exchange loan approvals for the current calendar year 1969, US\$10 million, is realistic and, barring unforeseen developments, it should achieve this volume. Forecasts of business for 1970 and the subsequent period are also conservatively based.

67. KDFC's present financial position is sound. Future operations and financial position are projected to remain satisfactory. Cash-flow in the future years is expected to be sufficient to service KDFC's debts with a comfortable margin. KDFC may therefore be considered a creditworthy borrower, and a suitable recipient for the proposed second Bank loan.

68. The Bank is expected to be the principal source of KDFC's foreign exchange requirements for at least the next two years. KDFC's needs for additional foreign exchange resources for the period up to mid-1971 are assessed at about \$20 million.

69. Under the first Bank Loan Agreement, the "free limit" was \$100,000. As noted in paragraph 39, KDFC's smallest foreign exchange loan so far is \$155,000, and accordingly the Bank has examined every loan proposal requiring the use of Bank funds. In view of the quality of KDFC's management and staff, of its loan appraisals, and of its follow-up work, it will be adequate for the purpose of close supervision of KDFC's use of Bank funds to examine loans using about three quarters, both by number and amount, of Bank funds. On the basis of the projects already under consideration by KDFC, it is estimated that with a free limit of \$300,000, prior approval of the Bank would be required in about 70% of the loans using Bank funds. It is recommended therefore that if a second loan agreement is entered into, the free limit should be raised to \$300,000 with a limit of \$5 million on the aggregate amount to be used for projects below the free limit.

70. The first Bank loan agreement provided for a concessional commitment charge, since KDFC was a new institution. It is recommended that for the proposed second Bank loan the Bank's standard practice be applied.

71. The following summarizes the recommendations concerning the proposed loan:

- (i) the amount recommended is US\$ 20 million;
- (ii) the terms and conditions should be similar to those of recent Bank loans to development finance companies including the standard commitment charge;
- (iii) KDFC's free limit should be raised to \$300,000.

KOREA DEVELOPMENT FINANCE CORPORATION

List of Shareholders

No. of Shares

I. FKI Members & Public

Ssangyong Cement Co., Ltd.	6,475
Hankuk Glass Industry Co., Ltd.	6,473
Hankuk Fertilizer Co., Ltd.	5,960
Jae Ho Chung	5,281
Pan Bon Spinning Co., Ltd.	5,000
Tong Yang Cement Co., Ltd.	4,768
Lucky Chemical Co., Ltd.	4,473
Korea Nylon Co., Ltd.	4,000
Hyun-Dai Const. Co., Ltd.	4,000
Hong Jai Cho	3,576
Yong Poong Trading Co., Ltd.	2,700
Korea Cement Mfg. Co., Ltd.	2,384
Korean Explosives Co., Ltd.	2,000
Gold Star Co., Ltd.	2,000
Taesung Lumber Ind'l Co., Ltd.	1,200
Chosun Silk Textile Co., Ltd.	1,200
Hankuk Wool Textile Co., Ltd.	1,200
Chunnam Textile Co., Ltd.	1,192
Samho Trading Co., Ltd.	1,192
Jedong Industrial Co., Ltd.	1,192
Duck Kyun Shin	1,192
Sam Yang Co., Ltd.	1,184
Kyungsong Spinning Co., Ltd.	1,104
Inchon Ironworks Co., Ltd.	1,080
Hanil Synthetic Fiber Co., Ltd.	1,080
Ilssin Industrial Co., Ltd.	1,000
Ilshin Industrial Co., Ltd.	1,000
Kyung Dong Sull	1,000

93 shareholders holding less than 1,000
shares each

9,094

84,000

II. Commercial Banks

The Cho Heung Bank	9,200
The Commercial Bank of Korea	9,200
The First City Bank of Korea	9,200
The Hanil Bank	9,200
The Bank of Seoul	<u>3,200</u>

40,000

No. of Shares

II. Insurance Companies

Korea Re-Insurance Co., Ltd.	10,000
Dae Han Life & Insurance Co., Ltd.	2,400
Dong Bang Life Insurance Co., Ltd.	2,400
Dae Han Educational Insurance Co., Ltd.	2,400
Dong Yang Fire & Marine Insurance Co., Ltd.	2,100
Shin Dong-A Liabilities Insurance Co., Ltd.	2,100
Dae Han Fire & Marine Insurance Co., Ltd.	2,100
The Kukje Fire & Marine Insurance Co., Ltd.	2,100
The Koryo Fire & Marine Insurance Co., Ltd.	2,100
The First Fire & Marine Insurance Co., Ltd.	2,100
Haedong Fire & Marine Insurance Co., Ltd.	2,100
The An-Kuk Fire & Marine Insurance Co., Ltd.	2,100
The Eastern Fire & Marine Insurance Co., Ltd.	2,100
Pan Korea Fire & Marine Insurance Co., Ltd.	2,100
Koryo Life Insurance Co., Ltd.	600
The First Life Insurance Co., Ltd.	600
Heung Kuk Life Insurance Co., Ltd.	600
	<u>40,000</u>

III. Foreign Shareholders

Bank of America	9,450
First National City Overseas Investment Corporation	9,450
United California Bank International	7,560
Irving International Financing Corporation	6,750
Deutsche Bank A.G.	6,750
The Chartered Bank	5,400
Banca Commerciale Italiana	5,400
The Industrial Bank of Japan, Limited	8,370
The Bank of Tokyo, Ltd.	8,370
	<u>67,500</u>
International Finance Corporation	<u>38,500</u>
	106,000
Total	<u>270,000</u>

KOREA DEVELOPMENT FINANCE CORPORATION

Board of Directors

(Elected at the Shareholders Meeting held on February 13, 1969)

Representing Korean Shareholders

Mr. Chai Sun Hong	(Chairman)
Mr. Chin Hyung Kim	(President)
Mr. Byoung Joon Lee	Governor, Korea Investment Development Corporation
Mr. Jae Ho Chung	Samko Textile Co. Ltd.
Mr. Suk Choon Lim	Governor, The Commercial Bank of Korea
Mr. Woo Dong Cho	President, Dong Bang Life Insurance Co. Ltd.
Mr. Yong Wan Kim	Kyungsong Spinning Co. Ltd.
Mr. In Hoi Koo	Lucky Chemical Co. Ltd.
Mr. Tai Sup Choi	Hankuk Glass Industry Co. Ltd.

Representing Foreign Shareholders

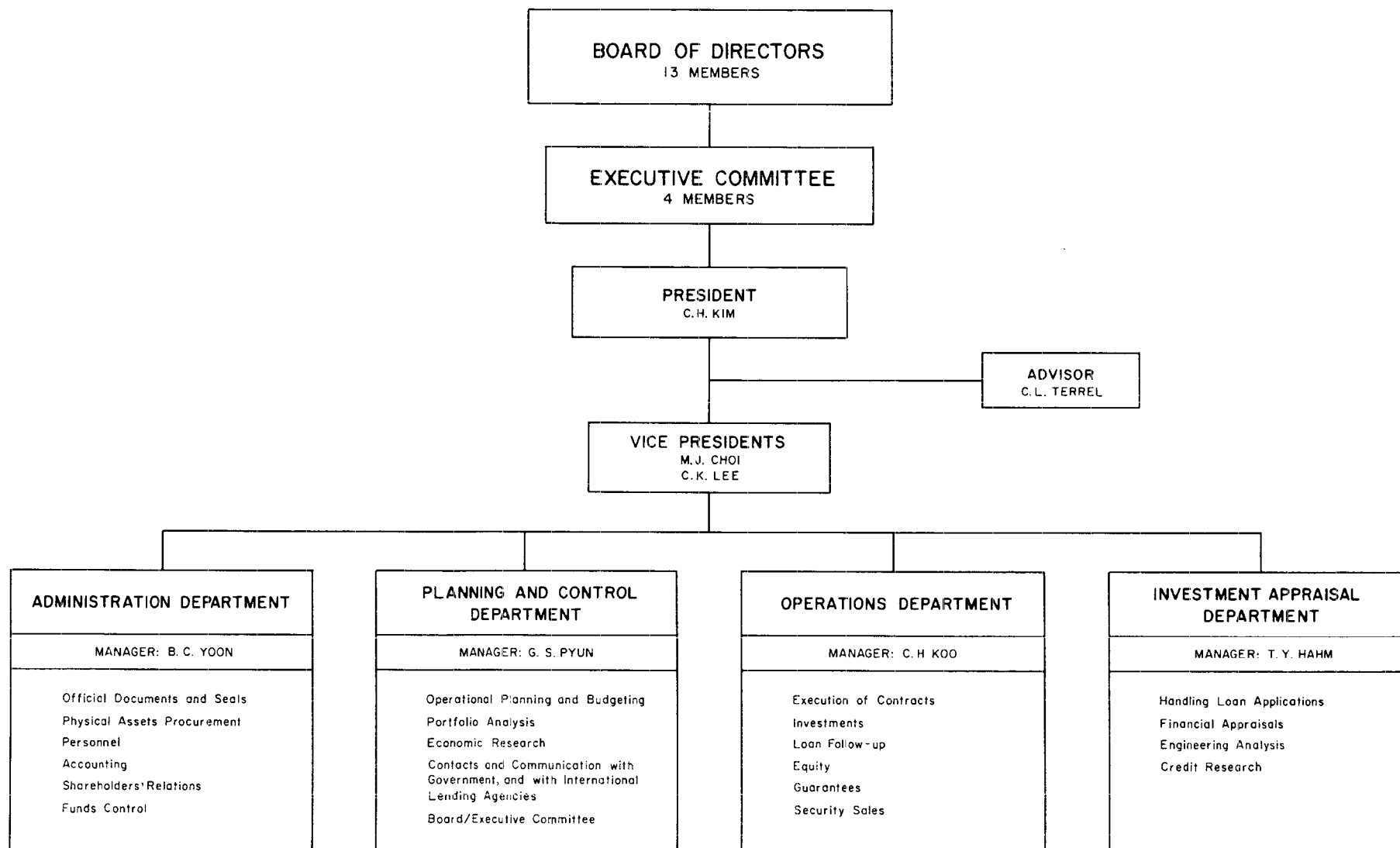
Mr. H. H. Liller	Seoul Manager, The Chartered Bank
Mr. Masahisa Shikano	Seoul Manager, Bank of Tokyo
Mr. David C. Colville	Tokyo Vice President, Bank of America

Representing IFC

Mr. Y. L. Chang	Adviser, International Finance Corporation
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KOREA: DEVELOPMENT FINANCE CORPORATION

ORGANIZATION CHART



KOREA DEVELOPMENT FINANCE CORPORATION

Statement of Investment and Operational Policies

(Adopted by the Board of Directors on April 25, 1967
and amended on February 29, 1968)

The Korea Development Finance Corporation, whose object is to promote the expansion of private enterprise in the Republic of Korea, will be guided by the policies set forth below:

I. The Scope of Investment Activities

- 1) KDFC will invest only in productive enterprises. While its primary activity will be manufacturing and processing industry, it may invest also in other types of enterprises, including transport, tourism, and large-scale commercially oriented agriculture. However, trade, real estate and small-scale agriculture will be excluded.
- 2) KDFC will finance only private enterprises which are properly organized and managed. KDFC will not invest in undertakings which are Government-owned and operated, but a Government holding of not more than 15% of the voting stock of a private enterprise shall not make such enterprise ineligible for financial assistance from KDFC. KDFC will finance both new enterprises and existing ones for expansion or improvement.
- 3) In its operations, KDFC will give due regard to the Government's general economic plans and policies. The following categories of industries will receive high priority, in accordance with the Government economic policies and objectives:
 - a) export industries;
 - b) import-substitute industries;
 - c) industries producing raw materials necessary for production of export commodities and import-substitutes;
 - d) indigenous local industries which have special advantage in comparative costs and potential marketability in foreign markets;
 - e) participation or assistance in the turn-over of the Government-owned industries to private ownership.
- 4) KDFC will assist private enterprises in the following ways:
 - a) medium and long-term loans;

- b) equity participation (through underwriting, conversion rights, direct participation in share capital or otherwise);
 - c) guarantee of payment for machinery and equipment imported or otherwise;
 - d) guarantee and underwriting of corporate securities;
 - e) technical and managerial consultant services; and
 - f) any other appropriate manner.
- 5) KDFC will seek through its operation, to broaden the ownership of private securities in Korea.
 - 6) KDFC's financial assistance will be primarily for expenditures for fixed assets. KDFC will, however, consider requests for permanent working capital in conjunction with its financial assistance for such capital expenditures.
 - 7) KDFC will study periodically the trend of over-all industrial development and investment opportunities in the private sector in cooperation with research institutes for promotion of new enterprises or expansion of the existing ones.

II. Basis for Investment Decisions

- 8) KDFC will make investment decisions only on the basis of sound investment criteria and standards, and will provide financial assistance only to those projects which are financially and economically sound and technically feasible. Special attention will be given to the ability of management and the profitability of the enterprise.

III. Diversification of Portfolio

- 9) KDFC will diversify its portfolio in order to maintain a reasonable level of risk.
- 10) KDFC will not provide financial assistance of less than the Won equivalent of \$50,000. The maximum financial commitment in whatever form, including loan, share capital or guarantee or any combination thereof, that KDFC may make to any single enterprise will not exceed 15% of the total of KDFC's paid-in capital, free reserves and Government loan of 1968.

- 11) KDFC will not commit to any single enterprise in form of share capital more than 10% of KDFC's paid-in capital and free reserves. The aggregate equity investment of KDFC at any time will not exceed the total of its paid-in share capital and free reserves.
- 12) In undertaking large-size projects, KDFC will seek cooperation with other financial institutions, both domestic and foreign.

IV. Turn-over of Portfolio

- 13) In order to recover its resources for new commitments and to encourage widespread ownership of private securities, KDFC will revolve its portfolio whenever it can do so on satisfactory terms. In selling an investment it will pay due regard not only to its own interests but also to the interests of other participants in such investment, as also to the interest of the concern whose shares are involved.

V. Relationship with Enterprises Financed

- 14) KDFC will not take a controlling interest in any enterprise in which it has invested, or any other interest which would give it primary responsibility for management, except that in the case of jeopardy, it may take such action as may be necessary to protect its interest. To this end it will not take up more than 25% of the share capital of an enterprise, except as the result of an underwriting commitment undertaken in the expectation that the investment would in fact be within the limit cited.
- 15) In accordance with normal banking practice, KDFC will require its borrowers to provide and to maintain adequate security, to keep records and accounts in accordance with sound accounting practices, and to furnish whatever information on their operations and accounts KDFC deems desirable. KDFC will take the right to inspect the enterprises it finances as well as their operations and accounts.
- 16) Business secrets and other information furnished by applicants or clients will be treated as confidential.

VI. Financial Guide-Lines

- 17) KDFC will lend and invest its resources in such a way as to maintain the value of its capital. KDFC will pass to its clients any foreign exchange risk it assumes or find other suitable means to cover it.

- 18) KDFC will not incur any debt (not including as debt the loan made by Korean Government in 1968) in excess of three times the aggregate of its paid-in capital, free reserves and the 1968 Government loan outstanding.
- 19) KDFC will maintain accounting records adequate to reflect its business operations in accordance with sound and generally accepted international accounting practices and standards. KDFC will employ qualified and independent public accountants to audit its books and certify the accounts annually.

VII. Profits and Their Distribution

- 20) KDFC will seek to develop earnings sufficient to cover expenses and taxes, to provide reserves adequate to the size and risks of its portfolio and to protect its equity against erosion and to pay satisfactory dividends. It will seek profits on its equity investments and will impose interest rates, fees and other charges for its loans and services which will permit it to achieve that level of profitability. It will build and maintain reserves consistent with sound financial management. It will set aside each year from net income before tax the amount required by law as the legal reserve. In addition, it will accumulate other reserves, including reserve for losses, as considered prudent by the Board of Directors.

VIII. Staff

- 21) KDFC will build up a technically qualified staff capable of carrying the responsibilities which KDFC's objectives create, and able to provide the services to clients which those objectives call for.

IX. Revision of Policies

- 22) Any proposal to revise this Statement of Investment and Operational Policies shall be considered by the Board of Directors only after each member has been given an adequate opportunity to study and comment on the proposal, and it shall be approved at a meeting of the Board of Directors by two-thirds of all directors.

KOREA DEVELOPMENT FINANCE CORPORATION

Audited Balance Sheet as of December 31, 1967 and 1968

ASSETS

	<u>1968</u>	<u>1967</u>
Current assets:		
Cash in banks	₩ 10,387,399	₩ 2,807,065
Demand deposits, interest bearing	147,000,000	-
Special deposit with the Korean Reconstruction Bank	1,655,000,000	-
Time deposits with banks, due within one year	1,727,118,400	516,060,000
Accrued interest receivable	20,395,952	2,426,249
Prepaid expenses	<u>232,535</u>	<u>-</u>
Total current assets	3,560,134,286	521,293,314
Time deposits, due after one year (₩5,000,000 in 1968 restricted for employees' severance pay)	7,000,000	382,000,000
Loans and investments	300,000,000	-
Property and equipment, at cost less accumulated depreciation and amortization	39,937,327	9,371,461
Other assets:		
Lease and other deposits	8,794,760	4,962,000
Organization expense, less amortization of ₩4, 186,480	<u>8,372,959</u>	<u>10,884,847</u>
	<u>17,167,719</u>	<u>15,846,847</u>
	<u>₩3,924,239,332</u>	<u>₩928,511,622</u>

<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	<u>1968</u>	<u>1967</u>
Current liability:		
Accrued expenses	₩ 1,112,008	₩ 1,273,381
Employees' severance liability	5,000,000	-
Long-term debt - Korean Reconstruction Bank loan	2,025,000,000	-
Stockholders' equity:		
Common stock, ₩5,000 par value:		
Authorized, issued and outstanding:		
1968 - 270,000 shares	1,350,000,000	820,000,000
1967 - 164,000 shares		
Retained earnings:		
Legal reserve	10,000,000	-
Voluntary reserve	90,000,000	-
Unappropriated:		
Balance, January 1	107,238,241	-
Appropriations for legal reserve and voluntary reserve	100,000,000	-
	<u>7,238,241</u>	<u>-</u>
Net income for year	435,889,083	107,238,241
Balance, December 31	<u>443,127,324</u>	<u>107,238,241</u>
	<u>543,127,324</u>	<u>107,238,241</u>
Total stockholders' equity	1,893,127,324	927,238,241
	<u>₩3,924,239,332</u>	<u>₩928,511,622</u>

IBRD/DFC

June 5, 1969

KOREA DEVELOPMENT FINANCE CORPORATIONAudited Statements of Income for the
Years ended December 31, 1967 and 1968

	<u>1968</u>	<u>1967</u>
Interest income:		
Loans	₩ 3,541,916	₩ -
Time and demand deposits	433,533,262	142,340,397
Special deposits, net of interest on loan - ₩76, 894, 520 in 1968	106,465,751	-
Other	<u>1,005,234</u>	<u>-</u>
	<u>544,546,163</u>	<u>142,340,397</u>
General and administrative expenses:		
Salaries, wages and benefits	47,493,402	13,272,747
Rent, utilities and supplies	16,621,803	5,843,986
Entertainment and public relations	12,500,354	5,908,030
Travel and transportation	9,017,434	3,935,081
Depreciation and amortization	7,097,983	2,952,258
Taxes and public levies	6,766,068	937,300
Professional services	5,809,694	1,230,000
Subscriptions and dues	2,468,654	276,515
Other	<u>881,688</u>	<u>746,239</u>
	<u>108,657,080</u>	<u>35,102,155</u>
Net income ^{1/}	<u>₩435,889,083</u>	<u>₩107,238,241</u>

^{1/} KDFC's interest income from bank time deposits is tax exempt. After excluding income from bank time deposits, KDFC had no taxable income in either 1967 or 1968.

IBRD/DFC

June 5, 1969

ANNEX VII

KOREA DEVELOPMENT FINANCE CORPORATION

Forecast of Approvals, Commitments and Disbursements, 1969-73

Year ending December 31	(Domestic currency: Won 000) (Foreign currency: \$ 000)					
	1968 (actual)	1969	1970	1971	1972	1973
<u>APPROVALS</u>						
Domestic currency loans	440,000	699,600	881,925	1,071,400	1,199,275	1,211,000
Domestic currency equity investments	140,000	125,400	163,075	193,600	203,225	218,900
Foreign currency loans	2,128	10,000	13,800	16,600	19,100	21,500
Total approvals (US\$ equivalent)	<u>4,199</u>	<u>14,000</u>	<u>17,600</u>	<u>21,200</u>	<u>24,200</u>	<u>26,700</u>
<u>COMMITMENTS</u>						
Domestic currency:						
Loans	390,000	554,675	836,275	1,024,100	1,167,100	1,208,350
Equity investments	<u>140,000</u>	<u>125,400</u>	<u>163,075</u>	<u>193,600</u>	<u>203,225</u>	<u>218,900</u>
Total commitments of domestic currency	<u>W 530</u>	<u>680,075</u>	<u>999,350</u>	<u>1,217,700</u>	<u>1,370,325</u>	<u>1,427,250</u>
Foreign currency loans:						
Total commitments of foreign currency	<u>461</u>	<u>8,150</u>	<u>12,850</u>	<u>15,900</u>	<u>18,475</u>	<u>20,275</u>
Total commitments (US\$ equivalent)	<u>2,353</u>	<u>10,623</u>	<u>16,484</u>	<u>20,328</u>	<u>23,458</u>	<u>25,465</u>
<u>DISBURSEMENTS</u>						
Domestic currency:						
Loans	160,000	454,850	744,975	929,500	1,103,300	1,202,300
Equity investments	<u>140,000</u>	<u>62,700</u>	<u>144,100</u>	<u>178,475</u>	<u>198,275</u>	<u>211,200</u>
Total disbursements in domestic currency	<u>300,000</u>	<u>517,550</u>	<u>889,075</u>	<u>1,107,975</u>	<u>1,301,575</u>	<u>1,413,500</u>
Foreign currency loans:						
Total disbursements in foreign currency	<u>-</u>	<u>3,113</u>	<u>5,343</u>	<u>12,850</u>	<u>15,900</u>	<u>18,475</u>
Total disbursements (US\$ equivalent)	<u>1,071</u>	<u>4,995</u>	<u>8,576</u>	<u>16,879</u>	<u>20,633</u>	<u>23,615</u>

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ANNEX VIII

KOREA DEVELOPMENT FINANCE CORPORATION

(US\$ 000)

Projected Income Statements, 1969-73

Year ending December 31	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
<u>INCOME</u>					
Income from loans - Interest	301	959	2,215	3,986	6,068
Capital gains	-	-	-	-	509
Dividend income	-	-	51	22	52
Income from short-term investments, deposits, etc.	<u>1,916</u>	<u>1,695</u>	<u>1,517</u>	<u>1,082</u>	<u>1,160</u>
Total income	<u>2,217</u>	<u>2,654</u>	<u>3,783</u>	<u>5,090</u>	<u>7,789</u>
<u>EXPENSES</u>					
Interest and commitment charges on borrowings	350	568	1,193	2,141	3,225
Salaries and other personnel expenses	178	235	310	384	455
Other administrative and general expenses	267	352	464	576	671
Provision for doubtful loans and investments	-	-	-	-	12
Total expenses	<u>795</u>	<u>1,155</u>	<u>1,967</u>	<u>3,101</u>	<u>4,363</u>
Profit before tax	1,422	1,499	1,816	1,989	3,426
Provision for tax	-	-	70	213	532
Net profit	<u>1,422</u>	<u>1,499</u>	<u>1,746</u>	<u>1,776</u>	<u>2,894</u>
<u>APPROPRIATIONS</u>					
Dividends	589	589	1,038	1,486	2,236
Reserves	<u>833</u>	<u>910</u>	<u>707</u>	<u>290</u>	<u>658</u>
	<u>1,422</u>	<u>1,499</u>	<u>1,746</u>	<u>1,776</u>	<u>2,894</u>
Net Profit as % of Paid-in Capital (end of the period)	28.9	30.5	17.6	17.9	19.5
Net Profit as % of Equity (end of the period)	18.4	17.3	15.3	15.2	16.7

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KOREA DEVELOPMENT FINANCE CORPORATION

(US\$ 000)

Projected Cash Flow Statements, 1969-73

Year ending December 31	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
<u>SOURCES:</u>					
Profit before tax	1,422	1,499	1,816	1,989	2,917
Add back non-cash charges (depreciation, provisions, write-off, etc.)	64	73	76	80	96
Increase in share capital	-	-	2,000	-	5,000
Draw-down on foreign currency borrowings	3,113	5,343	12,850	15,900	18,475
Domestic currency borrowings	-	-	-	-	-
Loan collections:					
Against domestic currency loans	73	395	594	802	968
Against foreign currency loans	-	-	408	890	2,274
Sales from portfolio (share investments or loans)	-	-	-	-	1,018
	<u>4,672</u>	<u>7,310</u>	<u>17,744</u>	<u>19,661</u>	<u>30,748</u>
<u>USES:</u>					
Increase in fixed assets	49	36	9	17	18
Disbursement of loans:					
Domestic currency	1,654	2,709	3,380	4,012	4,372
Foreign currency	3,113	5,343	12,850	15,900	18,475
Equity investments	228	524	649	721	768
Repayments:					
Against foreign currency borrowings	-	-	408	890	2,274
Payment of taxes	-	-	70	70	213
Payment of dividends	-	589	589	1,039	1,486
Increase (decrease) in short-term investments and cash	(372)	(1,891)	(211)	(2,988)	3,142
	<u>4,672</u>	<u>7,310</u>	<u>17,744</u>	<u>19,661</u>	<u>30,748</u>

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KOREA DEVELOPMENT FINANCE CORPORATION

(US\$ 000)

Projected Balance Sheets, 1969-73

As of December 31	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
<u>ASSETS</u>					
Cash & short-term deposits	287	365	446	502	525
Short-term investments and fixed deposits	12,249	10,207	9,909	6,785	9,820
Outstanding loans:					
Foreign currency	3,113	8,456	20,898	35,908	52,109
Domestic currency	2,163	4,477	7,263	10,473	13,877
Less provision for doubtful loans	-	-	-	-	12
	<u>5,276</u>	<u>12,933</u>	<u>28,161</u>	<u>46,381</u>	<u>65,974</u>
Equity investments	737	1,261	1,910	2,631	2,890
Fixed assets (net)	<u>257</u>	<u>293</u>	<u>302</u>	<u>319</u>	<u>337</u>
Total assets	<u>18,806</u>	<u>25,059</u>	<u>40,728</u>	<u>56,618</u>	<u>79,546</u>
<u>LIABILITIES AND EQUITY</u>					
Taxes payable	-	-	70	213	532
Dividends payable	<u>589</u>	<u>589</u>	<u>1,039</u>	<u>1,486</u>	<u>2,236</u>
	589	589	1,109	1,699	2,768
Foreign currency borrowings	3,113	8,456	20,898	35,908	52,109
Domestic currency borrowings (subordinated to other debt)	<u>7,364</u>	<u>7,364</u>	<u>7,364</u>	<u>7,364</u>	<u>7,364</u>
	10,477	15,820	28,262	43,272	59,473
Share capital	4,909	4,909	9,909	9,909	14,909
Reserve, unappropriated surplus	<u>2,831</u>	<u>3,741</u>	<u>1,448</u>	<u>1,738</u>	<u>2,396</u>
	7,740	8,650	11,357	11,647	17,305
Total liabilities and equity	<u>18,806</u>	<u>25,059</u>	<u>40,728</u>	<u>56,618</u>	<u>79,546</u>
Current Ratio	21:1	17:1	9:1	4:1	4:1
Total Long-Term Debt/Equity Ratio	1.3:1	1.8:1	2.4:1	3.7:1	3.4:1
Debt/Equity Ratio as defined in Bank Loan Agreement	0.2:1	0.5:1	1.1:1	1.9:1	2.1:1

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